DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **200826038**
Release Date: 6/27/08
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UIL:
501.07-00
512.01-00

Legend:

X =
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Dear

This is in reply to the letter of July 25, 2007, concerning the income tax consequences relating to an exchange of real property. X requested rulings under Sections 501(c)(7) and 512(a)(3)(D) of the Internal Revenue Code (Code).

FACTS

X is exempt from federal income tax as a social club under section 501(c)(7) of the code. X is operated for the primary purpose of providing golf, tennis and social club activities to its members. The X property includes 3 parcels of land, approximating a acres of which b acres is owned in fee simple. The other two parcels, c acres and

another d acres are leased from a related entity. Located on this property is a clubhouse, an 18 hole golf course, tennis facility, driving range, practice putting green and related facilities. X's club property has been used exclusively and continuously for operating and maintaining its stated exempt purpose. It has been asserted that no portion of this property has been used for investment purposes or for any purpose not directly related to golf, tennis, social and other recreational uses.

X has entered into a three party Master Agreement, hereafter referred to as MA. This MA spells out among other things that X and the lessor will mutually agree to terminate the long-term lease. The leased property held by the X will be returned to the lessor e years prior to the contractual termination of the lease.

The MA also calls for X to transfer f acres of X owned property directly to a third party developer. The third party developer will transfer to the club g acres of land. The g acres include h acres of land currently used as a i. The parties deemed that the i property has no other suitable purpose except for a golf course. The third party developer will also rough grade and construct certain infrastructure improvements on the X's new property in accordance with the MA.

The third party developer will also contribute j towards the construction of X's new facilities. X will finance the balance of the construction estimated to exceed k. The Developer will also indemnify X for up to l for the Developer's failure to perform the grading work in a timely and satisfactory manner. The lessor will indemnify X for up to m for any latent defects pertaining to the i property.

X has requested the following rulings:

1. The Transaction will not adversely affect X's tax-exempt status under Sections 501(a) and 501(c)(7).

2. Under sections 512(a)(3)(D), no gain shall be recognized by X as a result of the Transaction.

LAW

Section 501(c)(7) of the Code provides exemption for entities organized for pleasure, recreation, and other non-profitable purposes where substantially all of the activities are for such purposes and no part of the entities' net earnings inures to the benefit of any private shareholder.

Section 512(a)(3)(D) of the Code provides that if a section 501(c)(7) organization sold property used directly in the performance of its exempt function, and within a period beginning one year before the date of such sale and ending three years after such date, other property is purchased and used by such organization directly in the performance

of its exempt function, gain (if any) from such sale shall be recognized only to the extent that such organization's sales price of the old property exceeds the organization's cost of purchasing the other property.

Rev. Rul. 69-232, 1969-1 C.B. 154... holds that even though a profit is realized, the sale of property will not cause a social club to lose its exemption provided the sale is incidental in that it does not represent a departure from the club's exempt purposes.

In **Atlanta Athletic Club v. C.I.R.**, 980F.2d 1409(11th Cir 1993) it was held that the social club's property was "used directly" for recreation before it was sold and proceeds of sale were reinvested in recreational facilities, and thus, gain from sale was not "unrelated business taxable income" and would not be recognized for federal income tax purposes

ANALYSIS

Issue No.1 – Retaining Tax Exempt Status

The first ruling requested is whether the transaction would adversely affect X's tax-exempt status under § 501(c)(7) of the Code. Rev. Rul. 69-232, 1969-1 C.B. 154 provides that even though a profit is realized, the sale of property will not cause a social club to lose its exemption provided the sale is incidental in that it does not represent a departure from the club's exempt purposes. All of the facts and circumstances of a sale will be considered in determining the club's primary purpose in making the sale, including: (1) the purpose of the club in purchasing the property; (2) the use the club makes of the property; (3) the reasons for the sale; and (4) the method used in making the sale.

In situation 3 of Rev. Rul. 69-232, a golf club owned and occupied land in the suburbs of a large city. Over time the club's property increased in value but the facilities also had become antiquated and needed replacement. In addition, most of the members had moved farther out in the suburbs so that the close-in location was no longer important. Consequently, the club sold the property to land developers at a profit. The club then used the proceeds to purchase land and build a more modern clubhouse and golf course farther out in the country.

In this Revenue Ruling the Service determined that this sale was incidental within the meaning of the regulations. The primary purpose of the sale was not to make a profit, but to lower the club's overhead and improve its facilities by moving to a more suitable location. The Revenue Ruling also determined that "there is no requirement in the law that a club must continue to occupy uneconomical and outdated premises in order to continue its exemption." The sale did not adversely affect the exempt status of the club under § 501(c)(7) of the Code.

In this transaction X entered into a contract whereby it would mutually terminate and relinquish a long-term leased property in exchange for a larger acreage of land to be used in its exempt purposes; i.e. recreation and social activities for its members. This transaction also calls for X to receive funding towards infrastructure, construction of its new clubhouse, and indemnification towards specified potential liabilities.

This transaction is very similar to Situation No.3 of Rev. Rul. 69-232. In this case, like the holding in Situation No.3, X wishes to construct a more modern facility. Also, X needs to plan ahead to deal with the loss of golf course property at the expiration of the lease. Without such advanced planning, X's exempt recreation purpose could be jeopardized.

Issue No.2 – Recognition of Gain

The second question is whether the payments X receive are described under Section 512(a)(3)(D) of the Internal Revenue Code. Section 512(a)(3)(D) of the Code provides that if a section 501(c)(7) organization sells property used directly in the performance of its exempt function, and within a period beginning one year before the date of such sale and ending three years after such date, other property is purchased and used by such organization directly in the performance of its exempt function, gain (if any) from such sale shall be recognized only to the extent that such organization's sales price of the old property exceeds the organization's cost of purchasing the other property.

X entered into a contract with its lessor and a third party developer to exchange land to facilitate an expansion of its existing facilities and to construct a new clubhouse for use in its existing exempt purpose. The proposed transaction requires the X to terminate its lease in favor of the lessor and transfer approximately f acres of X owned property to the third party developer.

X stated that the property that will be conveyed has been used directly in its exempt function, namely, the golf course and the club house. Section 512(a)(3)(D) of the Code refers to 'direct use'. Since the real estate being sold was used directly in furtherance of X's exempt social purposes, any gain realized by X will qualify for nonrecognition treatment under § 512(a)(3)(D).

In S. Rept. 91-552, at 72 – 73 (1969), 1969-3 C.B. 423, 470 – 471, Congress addressed specifically the issue of non-recognition of reinvestment income by an exempt organization. The committee's bill provided that gains on the sale of assets used by the organizations in the performance of their exempt functions would be exempt from taxation. The proceeds must be reinvested in assets used for exempt purposes within a 1 year period beginning before the date of sale and ending three

years after that date. The committee reasoned that it was appropriate to exempt investment income from taxation because the organization was merely reinvesting funds formerly used to further it's exempt purpose; i.e., "where a social club sells its clubhouse and uses the entire proceeds to build or purchase a larger clubhouse, the gain on the sale will not be taxed if the proceeds are reinvested in the new clubhouse within three years."

X's sale of its property for the purpose of using the sales proceeds to purchase and construct a new golf course qualifies for nonrecognition treatment under § 512(a)(3)(D). This nonrecognition treatment is consistent with the intent of Congress and the holding in Rev. Rul 69-232. See also, Atlanta Athletic Club v. C.I.R.

It makes no difference that X is exchanging leasehold property for cash or other payments. In some states leasehold property may be considered personal property. Nevertheless, the leasehold property is sold within the meaning of IRC § 512(a)(3)(D). Nor does it matter that X receives various forms of consideration for the property sold to the lessor and developer. That X received land, cash, or services performed does not preclude non-recognition treatment. For purposes of this ruling, we will treat the real property transferred to X, including the graded land, as property purchased by X within the meaning of § 512(a)(3)(D).

Accordingly, we hold as follows:

1. The planned early termination of the lease and exchange of f for g acres will not adversely affect X's exempt status under section 501(c)(7) of the Code.

2. Under section 512(a)(3)(D) of the Internal Revenue Code, the gain shall not be recognized as a result of the early termination of lease and exchange of such property.

It was represented that the transferred fee simple property and the leasehold property were used by X to further its exempt purpose rather than as an investment property. We do not express any opinion as to whether any property was purchased or deemed purchased within the one year period prior to the MA or 3 years after such date. We also do not express an opinion as to the value of the property relinquished by X nor to the property acquired by X.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolved questions concerning your federal income tax status, this ruling should be kept in your permanent records.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437